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A Residual Damages Right Against the IRS: A Cure Worse than the Disease

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SPECIAL REPORT

TAX ANALYSTS

A RESIDUAL DAMAGES RIGHT AGAINST THE IRS: A CURE WORSE THAN THE DISEASE

By Steve Johnson

Steve Johnson is a professor at Indiana University School of Law-Bloomington. The author thanks Craig Bradley, John Glasscock, and William Popkin for comments. This article responds to a recent article by Professor Leandra Lederman (*Tax Notes*, May 22, 2000, p. 1133), proposing creation of an additional statutory provision permitting recovery of damages against the IRS. The author agrees with some of Professor Lederman's premises, but finds the proposal deficient. In his view, the proposal would accomplish little additional good. Also, he believes it would multiply unproductive litigation and would discourage the IRS from promulgating helpful guidance to its agents, thus increasing abuses. In the author's view, it would be better to maintain our commitment to the current general direction of taxpayer protection — while curbing its excesses and plugging its gaps — than to embark on the proposed new approach.

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Tax scholarship commonly has emphasized the substantive rules of tax liability, according less than due attention to tax procedure. Recently, however, this imbalance has been partly redressed as a result of the taxpayer rights movement. The major legislative products of the movement have been the Taxpayer Bill of Rights (TBOR1) in 1988,[1] the Taxpayer Bill of Rights 2 (TBOR2) in 1996,[2] and the Taxpayer Bill of Rights 3 (TBOR3) in 1998.[3] Congress currently is considering a fourth installment in the series.[4] These measures — especially TBOR3 — have provoked considerable useful commentary from both practitioners and academics.[5]

Nonetheless, much work remains to be done in analyzing the taxpayer rights phenomenon. Recently, in these pages, Professor Leandra Lederman made

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[1]Title IV, subtitle J, of the Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, 102 Stat. 3342, 3730.

[2]Pub L. No. 104-168, 110 Stat. 1452.

[3]Title III of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685. A lesser enactment of the series was the Taxpayer Browsing Act, Pub. L. No. 105-35, 111 Stat. 1104 (1997).

[4]The Taxpayer Bill of Rights 2000, H.R. 4163, was approved unanimously by the House in April.

[5]My writings on taxpayer rights initiatives include "Unfinished Business on the Taxpayer Rights Agenda: Achieving Fairness in Transferee Liability Cases," 19 *Va. Tax Rev.* 403 (2000) (discussing TBOR2's creation of a right of contribution for section 6672 cases and proposing a similar remedy for transferee liability cases); "The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules," 84 *Iowa L. Rev.* 413 (1999) (hereafter Section 7491) (discussing section 7491, created by TBOR3); "Tax Advisor-Client Privilege: An Idea Whose Time Should Never Come," *Tax Notes*, Feb. 23, 1998, p. 1041 (discussing TBOR3 measure ultimately enacted as section 7525 (section references are to the Internal Revenue Code of 1986, as amended, except as otherwise noted)).

Articles by others on taxpayer rights topics include, among many other works, Nathan Clukey, "Examining the Limited Benefits of the Burden of Proof Shift," *Tax Notes*, Feb. 1, 1999, p. 683 (section 7491); Louis F. Lobenhofer, "The New Tax Practioner Privilege: Limited Privilege: Limited Privilege and Significant Disruption," *Tax Notes*, June 14, 1999, p. 1619 (section 7525); Robert B. Nadler, "The Qualified Offer: A Fee Shifting Procedure to Encourage Settlement," *Tax Notes*, Dec.

(Footnote 5 continued on next page.)

another contribution to the effort.[6] Tax procedure scholarship has frequently been graced by Professor Lederman's work, and her stimulating articles always are welcome. Unfortunately, I am compelled to register doubts as to the proposal offered in her recent article.

After surveying current taxpayer rights measures, Professor Lederman's article discusses and deplores legislation by "horror stories," the tendency to stampede into hasty enactment of dubious measures because of the emotive power of one or a few anecdotes. She rightly observes that "[t]he primary risk of anecdote-driven legislation is overcompensation."[7] She also is concerned about undercorrection, describing objectionable behavior by IRS agents, especially (1) a 1973 incident, discussed in the *Payner* case,[8] involving an unconstitutional search of another person's property to obtain evidence that the taxpayer falsified his return[9] and (2) a 1982 incident, discussed in the *Lojeski* case,[10] involving improper nominee lien and levy.[11] Other examples of alleged wrongdoing are mentioned with less emphasis.[12]

Three conclusions are drawn from Lojeski's story: that individual IRS employees sometimes do abuse their power, escaping without sanction; that procedural rights do not necessarily protect taxpayers from such abuses; and that "procedural rules are useless without remedies for their violation."[13] By way of solution, Professor Lederman suggests enactment of a new code section — section 7438 — that would authorize additional damages suits against the IRS in federal district court.[14] The new section would have these salient features:

- Damages would be authorized if any IRS person knowingly or negligently "commits with respect to a taxpayer, any act that materially violates the [code, any regulation], any Revenue Procedure, or any provision of the Internal Revenue Manual."
- The section would be residual, applying if other code sections authorizing damages suits[15] are inapplicable.
- Unlike many current provisions, neither exhaustion of other remedies nor mitigation of damages would be required in order to obtain damages.
- Exceptions would include good faith errors by the IRS, acts requested by the taxpayer, and acts resulting in actual damages of under $1,000.
- The successful plaintiff could recover actual damages, costs, and reasonable attorneys fees, and, in cases of willfulness or gross negligence, punitive damages.

I understand the concerns driving the proposal and agree with many of them. Nonetheless, the proposal represents a fundamental departure from the direction Congress has taken thus far in taxpayer rights legislation — in my view, an unwise departure. Part I below explains the radical nature of the proposal. Part II asserts that the proposal reflects the same failing for which Congress is rightly criticized: anecdote-driven overcorrection. Part III demonstrates that enactment of the proposal would multiply wasteful litigation, im-

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28, 1998, p. 1657 (section 7430); Toni Robinson and Mary Ferrari, "The New Innocent Spouse Provision: 'Reason and Law Walking Hand in Hand'?," *Tax Notes* Aug. 17, 1998, p. 835 (section 6015).

[6]"Of Taxpayer Rights, Wrongs, and a Proposed Remedy," *Tax Notes*, May 22, 2000, p. 1133 [hereafter Rights, Wrongs and Remedy]. A previous contribution of hers was "Unforeseen Consequences of the Burden of Proof Shift," *Tax Notes*, July 20, 1998, p. 379 (discussing section 7491).

[7]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1136.

[8]*United States v. Payner*, 447 U.S. 727 (1980).

[9]The IRS suspected that the Castle Bank of the Bahamas was acting as an illegal tax haven for American taxpayers. While he was in the United States on a business trip, Wolstencroft, an officer of Castle, stayed with Kennedy, a private detective employed by an informant of the IRS. While Wolstencroft and Kennedy were at dinner, IRS personnel took Wolstencroft's briefcase from Kennedy's apartment, opened the lock, and photographed over 400 documents in it. Based on the photographed evidence, the IRS established Payner's connection to a Castle account and obtained a criminal conviction against Payner for filing a false income tax return. The Supreme Court upheld the admissibility of the photographed evidence because of "the established rule that a court may not exclude evidence under the Fourth Amendment unless it finds that an unlawful search or seizure violated the defendant's own constitutional rights." *Id.* at 731. Payner had no privacy interest in Wolstencroft's briefcase.

[10]*Lojeski v. Boandl*, 788 F.2d 196 (3d Cir. 1986).

[11]Thomas Treadway resided with Shirley Lojeski on her farm. They were "companions and very best friends." *Lojeski v. Boandl*, 602 F. Supp. 918, 922 (E.D. Pa. 1985). Believing that Treadway had underpaid his income taxes and was liquidating his assets (transferring them to Lojeski to shield them), the IRS agent made jeopardy and termination assessments against Treadway and imposed nominee liens and levies against Lojeski. The agent did not obtain all required approvals of the liens and levies. Pursuant to administrative review under section 7429, the IRS abated the assessments, released the liens, and returned the levied amounts with interest. Lojeski brought a *Bivens* action against the agent and others for violation of her Due Process and Fourth Amendment rights, seeking damages for costs, lost opportunities,

(Footnote 11 continued in next column.)

business interruptions, and humiliation and "degradation." The Third Circuit rejected her cause on the grounds that rules in the Internal Revenue Manual do not establish a due process standard and that imposition of liens and levies do not violate privacy interests.

[12]*See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1140 n.89.

[13]*Id.* at 1139.

[14]*See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141-1142 for proposed wording of the new section.

[15]*See* sections 7426(h) (damages for wrongful levies and certain other collection actions); 7431 (damages for unauthorized inspection or disclosure of tax returns and return information); 7432 (damages for failure by IRS to release tax lien); 7433 (damages for certain unauthorized tax collection actions); 7435 (damages for unauthorized IRS enticement of information disclosure by taxpayer representatives); *cf.* section 7430 (recovery by taxpayers of certain administrative and litigation costs).

posing costs on all parties. The consequent burdens would be disproportionate to the small number of meritorious claims that would be vindicated under the new remedy but would not be vindicated under the current system. Finally, Part IV suggests that enactment of the proposal likely would decrease the guidance the IRS gives to its agents. This would produce more abuses rather than fewer.

I. Radical Departure

Both the current tax administration system, as modified by taxpayer rights measures to date, and Professor Lederman's approach recognize the potential imbalance of power between taxpayers and the IRS and seek to address the abuse possibility inherent in it. They do so in fundamentally different ways, however.

Proposed section 7438 would greatly expand the litigation option and would move it to the front of the line, at least in the perception of persons who believe themselves to have been abused by the IRS.

The current system takes a four-fold approach. First, the principal thrust consists of an elaborate set of rules governing examination, collection, and controversy resolution. These rules require the IRS to take certain steps, prohibit it from taking others (or permit them only on higher-level approvals, administrative review, and/or judicial review), and grant taxpayers and affected third parties various affirmative rights. Second, those rules are implemented within the IRS by a new management committed — with strong congressional backing and reinforced by external review[16] — to taxpayer service and to changing the culture of the Service in "customer"-friendly directions.[17] Third, the rules are made meaningful to IRS agents and officers in the field by new personnel rules and sanctions, under which they can be fired for engaging in taxpayer abuse and other misconduct.[18] Finally, there are a limited number of sections authorizing taxpayer actions for damages or cost-shifting.[19] The damages sections are selective, not comprehensive, covering only particular categories of conduct and violation of higher-order rules.

In contrast, proposed section 7438 would greatly expand the litigation option and would move it to the front of the line, at least in the perception of persons who believe themselves to have been abused by the IRS. Five features of proposed section 7438 would lead to this reversal:

(1) Although damages now are available only in selected types of cases, section 7438 would apply to types of misconduct across the board, without categorical limitation.[20]

(2) Although existing damages sections often are triggered only by IRS violation of rules in statutes or regulations,[21] section 7438 would be triggered also by conduct contrary to a revenue procedure or the Internal Revenue Manual.[22]

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[16]Since January 1999, 218 audits of IRS implementation of taxpayer rights have been initiated by the Treasury Department's Inspector General for Tax Administration and 138 such audits have been initiated by the General Accounting Office. The completed Inspector General reports proposed 375 specific recommendations; the completed GAO reports contained 94 recommendations. In addition, the National Taxpayer Advocate identified the top 20 problems affecting taxpayers and made recommendations as to them. The IRS took these suggestions seriously, devoting significant management attention and resources to their implementation. *Statement of Charles O. Rossotti Before the Annual RRA '98 Joint Hearing on IRS Progress, Doc 2000-12461 (64 original pages), 2000 TNT 87-43*, para. 74 (May 4, 2000).

[17]*See, e.g.*, Charles O. Rossotti, "Modernizing America's Tax Agency," *Tax Notes*, May 24, 1999, p. 1191. Given the size of the IRS, its local variabilities, and the tenacity of bureaucratic self-protection, the ability of top management to effect widespread and durable changes in institutional culture cannot be assumed. The jury is still out, but the efforts being made are worthy of note.

[18]Section 1203 of TBOR3 requires firing any IRS employee who commits any of 10 acts or omissions: (1) "willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets"; (2) "providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative"; (3) violating any right under the Constitution or designated civil rights statutes; (4) falsifying or destroying documents to conceal mistakes; (5) assault or battery; (6) violating code, regulations, or manual rules to retaliate against or harass a taxpayer, taxpayer representative, or IRS employee; (7) willful misuse of the section 6103 confidentiality rules to conceal information from Congress; (8) willful failure to file a tax return; (9) willful understatement of tax liability; and (10) "threatening to audit a taxpayer for the purpose of extracting personal gain or benefit."

[19]*See* note 15 *supra*.

[20]Except for categories for which relief is available under other damages sections. *But see* subpart III.B. *infra* as to ambiguities in this exception. The other suggested exceptions (good faith error, action requested by taxpayer, and actual damages under $1,000) are situational, not categorical.

The reach of some of the exceptions is unclear. For instance, what if the IRS agent in *Lojeski* honestly believed in good faith (though erroneously) that no further approval of the nominee lien and levy was required? Would new section 7438 then fail to grant redress to Ms. Lojeski? Alternatively, perhaps good faith can never exist as to knowing or negligent violations of law. *Cf. Harlow v. Fitzgerald*, 457 U.S. 800, 815 (1982) ("good faith" official immunity defense against *Bivens* action not available if the official knew or reasonably should have known that his action violated the Constitution). But, were this latter view taken, the proffered "good faith" exception would be a dead letter. The exception would immunize nothing that falls within the predicate rule in the first place.

[21]*See* sections 7426(h)(1) (disregard of provisions of the code); 7432(a) (adverting to standards in section 6325); 7433(a) (disregard of statute or regulation).

[22]*See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141.

(3) In contrast to current damages sections,[23] section 7438 would contain no requirement that the allegedly aggrieved taxpayer have exhausted administrative remedies available within the IRS. There is no requirement within section 7438 that the plaintiff notify the IRS of the problem or request the IRS to correct it. There is no requirement that the plaintiff bring to completion, or even initiate, any corrective mechanism provided by law. Indeed, "[n]otwithstanding any other provision of law, [a section 7438 damages suit] may be brought . . . at *any* time within two years after the date of discovery by the plaintiff of the prohibited act."[24]

(4) Unlike existing damages provisions,[25] section 7438 would contain no requirement that the plaintiff take any steps reasonably within her power to mitigate the amount of damages.

(5) Section 7438 would offer a potentially much larger pot of gold at the end of the litigation rainbow. Most existing code damages sections limit relief to something like "actual, direct economic damages" plus costs; they do not offer punitive damages; and they often have damages caps.[26] In contrast, damages available under new section 7438 would include "actual damages" — a term intended to be broader than "actual, direct economic damages";[27] those actual damages would be unlimited on the "up side," subject to no cap;[28] and punitive damages would be available as to willful or grossly negligent conduct.[29]

To recapitulate, the current system, including taxpayer rights legislation to date, seeks first to prevent or deter IRS misconduct. If misconduct occurs, the system seeks to undo it through administrative self-correction and/or judicial intervention. Only in selected circumstances and only as a last resort, does the current system offer the opportunity to litigate for monetary compensation. Proposed section 7438, however, would allow damages to be sought without categorical limit, would broaden the types of misconduct deemed appropriate for damages, would eliminate any need to let the IRS try to undo its wrong or for the taxpayer to reasonably mitigate losses from that wrong, and would dangle a considerably larger carrot before the eyes of potential plaintiffs.

It is not hard to predict how behavior would change under the new regime. Self-correction within the system would become an afterthought. Actually or arguably aggrieved taxpayers' first moves would be to file section 7438 complaints in district court. A "litigate first" approach cannot be the way to achieve effective tax administration in this country. The ensuing parts explain why.

II. Enough Anecdote-Driven Legislation

As previously noted, Professor Lederman decries tax legislation by "horror stories." She is right to do so. Before TBOR3, there *were* real and substantial problems in the IRS, and TBOR3 *does* contain some useful ameliorations. On the whole, though, the statute Congress produced at the end of the legislative process is inferior to the working document (the report of the Kerry-Portman Commission[30]) on hand at the start of that process. The reason for this retrogression is that the sensationalistic, anecdote-driven, and ultimately (too late) discredited[31] hearings of the Senate Finance Committee created an anti-IRS frenzy in which the administration did not seriously oppose, and Congress adopted, a number of ill-considered "reforms" not urged by the Kerry-Portman Commission.[32]

Legislation by horror story is not new, of course.[33] Indeed, it is rooted in human nature.[34] Nonetheless, it is right to point out its pernicious effects, as Professor Lederman does, and to try to craft institutional safeguards to curb this mischievous proclivity.[35] However, in our context, there are two problems: (1) the tendency of anecdotes to drive legislation provides no warrant

[23]*See* sections 7426(h)(2); 7432(d)(1); 7433(d)(1); *cf.* section 7430(b)(1) (exhaustion requirement for cost shifting).

[24]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (section 7438(d)) (emphasis added). This is the statute-of-limitations portion of section 7438 and is modeled on existing sections. Nonetheless, its language reinforces the fact that utilization of other remedies would not be prerequisite to a section 7438 suit. This appears to be a choice by Professor Lederman, not an accident of drafting, since she notes and appears to regret the existence of exhaustion requirements in current damages sections. *See id.* at 1139-40.

[25]*See* sections 7426(h)(2); 7432(d)(2); 7433(d)(2); *cf.* section 7430(b)(3) (mitigation rule as to cost shifting).

[26]*See* sections 7426(h)(1); 7432(b); 7433(b); 7435(b); *cf.* section 7430(c)(1) and (2) (limits as to cost shifting). *But see* section 7431(c)(1)(ii) (punitive damages for willful or grossly negligent inspection or disclosure of returns or return information).

[27]*See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141.

[28]As a *de minimis* rule, no damages would be available if actual damages suffered by the taxpayer were under $1,000. *Id.* (Section 7438(b)(3)).

[29]In addition, costs and reasonable attorneys fees would be available. *Id.* (Section 7438(c)).

[30]*Report of the National Commission on the Restructuring of the Internal Revenue Service* (1997).

[31]*See* note 62 *infra*.

[32]*See* Johnson, Ssection 7491, *supra* note 5, at 446-48.

[33]*See, e.g.,* Michael J. Graetz, *The Decline [and Fall?] of the Income Tax* 32-33 (1997) (describing the story of Vivien Kellems, which drove 1969 legislation "that continues to haunt the income tax today" through the problem of the marriage penalty).

[34]It is a characteristic of human beings generally, not just legislators, to disproportionately credit vivid personal examples over cold statistics or disembodied generalizations.

[35]A modest step might be amending the confidentiality rules of section 6103 to allow the IRS to rejoin more specifically when a taxpayer testifies to Congress about how she believes the IRS mistreated her. Knowing that their "embellishments" could be challenged might cause some to choose not to be witnesses, but the country would be better off if indefensible allegations were omitted in the first place.

for a new damages remedy, indeed (2) Professor Lederman's argument appears to be driven by the anecdotalism that she properly denounces.

A. No Warrant

Professor Lederman correctly states that "[t]he primary risk of anecdote-driven legislation is overcompensation,"[36] that is, reining in the IRS too much rather than too little. Needless to say, however, that realization should inspire caution, not enthusiasm, about adopting so sweeping a change as section 7438.

> ***The sensationalistic, anecdote-driven, and ultimately (too late) discredited hearings of the Senate Finance Committee created an anti-IRS frenzy in which Congress adopted a number of ill-considered 'reforms.'***

There is a way, though, in which Professor Lederman seeks to link "legislation by horror stories" to her proposal. She contends: "A less obvious risk of anecdote-based legislation is that, in providing politically popular legislation, they may not provide real remedies for genuine abuses."[37] No support is offered for this assertion, however, and it is hard to find evidence for it in the TBOR3 experience. To be sure, TBOR3 contains a number of provisions that are empty, merely symbolic, or even cynical.[38] But that's not all it contains. Many TBOR3 provisions — the spousal relief, collection due process, "10 deadly sins," offer-in-compromise, and installment agreement provisions, for instance — have real importance (whether for weal or for woe).[39]

TBOR3 does not reflect a Congress inclined to address genuine problems with only cosmetic solutions. There is no inherent reason why "legislation by horror stories" need engender only superficial legislative fixes, and, on the recent historical experience, it hasn't.

In short, I agree with almost everything Professor Lederman has to say about anecdote-driven legislation, but I do not see those observations as providing a warrant for a comprehensive damages remedy like proposed section 7438.

B. Same Error

Based on the case advanced for it, section 7438, if enacted, would be another instance of anecdote-driven legislation. In particular, the second half of the article proposing section 7438 invokes the *Lojeski* story[40] time after time. For the following three reasons, that perspective would lead to the overcompensation that is the prime risk from anecdotalism.

(1) Many of the anecdotes by which section 7438 is justified are old, and the significance of taxpayer rights changes since then have not been sufficiently credited. All or nearly all of the cited cases of abuse occurred before the TBOR2 and TBOR3 changes became effective — many long before. For instance, the *bete noire* Lojeski incident took place in 1982; the Payner incident occurred in 1973; and some other examples are of similar vintage.[41]

I do not suggest that TBOR2 and TBOR3 have ushered us into a magical realm where no IRS abuse ever again will occur. But I do contend that they and parallel developments will substantially change the way the IRS does business and substantially decrease the frequency and seriousness of IRS misconduct.[42] This change should receive considerable attention in deciding whether, weighing its probable benefits against its probable costs, a comprehensive damages remedy should be created.

Consider *Lojeski*. Had that situation arisen in 2000 instead of 1982, the IRS agent's excessive "zeal" would have been opposed not only by the Internal Revenue Manual provision there violated but also by new statutory rules enacted by TBOR3. For example, under TBOR3, absent jeopardy, a principal residence can be levied on only with a district court's written approval and business property can be levied on only with personal, written approval of a district director or assistant district director.[43] Also, the TBOR3 collection due process rules[44] require that, absent jeopardy, a taxpayer

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[36]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1136.

[37]*Id.*

[38]*See, e.g.*, Johnson, Section 7491, *supra* note 5, at 446-58.

[39]These and other provisions have dramatically reduced IRS levies on residences and businesses. *See, e.g.*, David Cay Johnston, "IRS Collection Efforts Shrink as New Law Takes Effect," *Chattanooga Times & Free Press*, May 19, 1999, at C4. The following compares IRS collection actions for fiscal year 1998 with such actions for fiscal year 1999, when the TBOR3 changes became effective:

	FY 1998	FY 1999	% Decline
Liens	382,755	167,867	56%
Levies	2,503,409	504,403	80%
Seizures	2,307	161	93%

See Joint Comm. on Taxation, "Report Relating to the Internal Revenue Service as Required by the IRS Reform and Restructuring Act of 1998," *Doc 2000-12222 (62 original pages), 2000 TNT 84-67*, section 134 (May 1, 2000).

[40]*See* notes 10-11 *supra*.

[41]Such as the Nixon-era Operation Leprechuan. *See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1140 n.89 (*citing* Ridgeley A. Scott, "Suing the IRS and Its Employees for Damages: David and Goliath," 20 *S. Ill. U. L. J.* 507, 572 (1996)).

[42]Indeed, in the post-TBOR3 environment, the greater danger may be that the IRS will not be vigorous enough in collecting taxes, not that it will be too aggressive or contemptuous of legitimate taxpayer interests. *See* note 39 *supra*.

[43]*See* section 6334(a)(13), (e).

[44]For comprehensive discussion of these rules, see Leslie Book, "The New Collection Due Process Taxpayer Rights," *Tax Notes*, Feb. 21, 2000, p. 1127.

receive administrative and judicial review promptly after notice of tax lien is filed[45] or *before* levy is made.[46]

It might be argued that the jeopardy exceptions would render these new safeguards ineffective in a *Lojeski*-like case. Indeed, the agent did obtain approval from his superiors for a jeopardy assessment against Lojeski's friend Treadway (although not for collection action against Lojeski).[47] However, there are new controls on jeopardy determinations, too. TBOR3 requires, in addition to other approvals, that IRS Counsel must approve in writing any jeopardy assessment.[48] IRS agents have new and powerful reasons to learn these rules and to follow them. Under the "10 deadly sins" provision, an agent will be fired for "willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets."[49] Confronted with this possibility, few agents are likely to engage in brinksmanship, hoping for protection under the "willfulness" element.[50]

I agree with almost everything Professor Lederman has to say about anecdote-driven legislation, but I do not see those observations as providing a warrant for a remedy like proposed section 7438.

It is theoretically possible that these and other safeguards could be violated or circumvented in a future case like Lojeski's. Yet, their cumulative deterrent effect is formidable. When multiple protections exist, when they are statutory not just directive, when IRS agents have been trained as to the new rules,[51] and when dismissal looms as the consequence for violation, it is hard to think that *Lojeski*-like cases are likely to recur soon or often. A proposal driven by that anecdote gives inadequate due to the substantial prophylactic measures enacted in recent years.[52]

(2) Assume that existing taxpayer protections fall short, even after the torrent of recent additions. Gaps can be plugged. A comprehensive damages remedy is needed only if there is some reason why the system cannot be improved by less radical means. The rationale advanced for section 7438 under-appreciates the ability of the current system to respond to abuses through further targeted measures.

Despite some notorious episodes, litigation thus far under existing damages sections has not been excessively wasteful or burdensome.

I have already discussed this ability at the legislative level, noting that there is no inherent reason why current legislative patterns must result in empty or remedy-less rights.[53] The courts too have shown this ability. The courts are said to "have struggled" with how to enforce section 7522.[54] Yet in the cases cited, the courts decreed meaningful remedies for inadequately descriptive IRS notices: shifting the burden-of-proof to the IRS[55] or even invalidating the notice.[56]

(3) Too much is risked for too little. Analyzing the limited reach of current damages sections, Professor Lederman remarks: "if a case similar to Lojeski's arose today, the code would not provide much solace."[57] But the quest to eradicate every last possibility of future, uncompensated harm is too one-pointed in its focus. Recent changes already have done much; further targeted, less radical reforms could do more; and, as shown by Parts III and IV, significant disadvantages would ensue from a comprehensive damages remedy to address remaining misconduct possibilities. The concern for horror stories that sometimes has led to ill-considered congressional action should not propel us to embrace an undesirable approach like section 7438.

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[45]*See* section 6320.

[46]*See* section 6330.

[47]*See Lojeski v. Boandl*, 602 F. Supp. 918, 922 (E.D. Pa. 1985).

[48]*See* section 7429(a)(1)(A) (replacing a Manual requirement); *see also* section 6343(d) (requiring return of property when levy was improperly made).

[49]TBOR3, section 1203(b)(1).

[50]*See* Johnston, *supra* note 39 (quoting a "veteran tax collector in Manhattan" as saying: "I'm not going to risk my job on that [the difference between an honest mistake and an intentional violation], and I don't believe anyone else would either.").

[51]For description of such training efforts, see General Accounting Office, "IRS' Implementation of the Restructuring Act's Taxpayer Protection and Rights Provisions, GAO/GGD-00-85," *Doc 2000-14670 (25 original pages), 2000 TNT 101-15*, sections 16-28 (April 1, 2000); Amy Hamilton, "Watch the IRS Run," *Tax Notes*, Jan. 3, 2000, p. 18, at 18-19 (by early 1999, the IRS had given 60,000 frontline workers more than 1.5 million hours of basic training in TBOR3 and was moving into more in-depth training).

[52]Two of the other cited examples of "IRS abuses of power" are the *Huffman* and *Han* cases. *See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1140 n.89. But in both of those cases, existing protections worked — the taxpayers received compensation from the IRS for their reasonable litigation and administrative costs. *See Huffman v. Commissioner*, 978 F.2d 1139 (9th Cir. 1992); *Han v. Commissioner*, 66 T.C.M. 499, *93 TNT 177-30* (1993).

[53]*See* part II.A. *supra*.

[54]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1139.

[55]*See Shea v. Commissioner*, 112 T.C. 183 *Doc 1999- 12501 (44 original pages), 1999 TNT 63-3* (1999); *Straight v. Commissioner*, 74 T.C.M. 1457, *Doc 98-346 (31 pages), 97 TNT 250-13* (1997).

[56]*Scar v. Commissioner*, 814 F.2d 1363 (9th Cir. 1987) (pre-section 7422 case).

[57]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1140.

III. More Waste, Costs, and Burdens

Even given recent taxpayer rights changes, there might be some cases in which section 7438 would provide a worthwhile remedy not provided by current law. I suspect, though, that such instances would be far outnumbered by cases in which claims of little merit are asserted. As a result, substantial costs in time, effort, and money would be inflicted on both litigants and the courts. These concerns have special moment now. The federal courts already confront burgeoning case loads, threatening the quality and timeliness of justice they dispense.[58] Caution is required as we consider adding to this burden.

Despite some notorious episodes,[59] litigation thus far under existing damages sections has not been excessively wasteful or burdensome.[60] This is partly explained by the fact that some of those sections were created or expanded only recently,[61] so that their effects have yet to be registered. Additionally, though, it reflects Congress's circumspection in crafting only selective, not universal, damages remedies.

However, there are four grounds on which to believe that section 7438 would produce considerable litigation — much of it meritless — imposing excessive burdens on the resources of courts and litigants. One of these grounds is historical: experience under various TBOR3 provisions. The other three grounds involve aspects of section 7438 or the rationale offered for it: the relation of section 7438 to existing code damages sections, the relation of section 7438 to the exclusionary rule, and the "insufficient explanation" class of cases.

A. TBOR3 Experience

Consider both the pre-enactment history of TBOR3 and its post-enactment results. As to the former, taxpayers testified to the Senate Finance Committee about alleged IRS abuses, but the validity of much of that testimony has been called into question.[62] At least some who testify without adequate basis would be inclined to bring damages suits without adequate basis.

The full post-enactment story remains to be told, especially because of the newness of TBOR3.[63] Yet results thus far inspire caution. Professor Lederman states that some of the recent taxpayer rights changes "impose burdens on every tax controversy. The multiplication of procedures imposes more costs on the IRS, costs that taxpayers bear. It may also increase the burden on courts."[64] She is right. As partial evidence,

- One of the TBOR3 measures was enumeration of the "10 deadly sins," commission of which will cause an IRS employee to be fired.[65] Many of the complaints now being made as to such violations lack merit.[66] As of Fall 1999,

> 235 misconduct investigations [had] been completed, of which 161, or about 68 percent, were found to lack merit. In 33 cases, or 14 percent, some form of misconduct was found; in most cases employees failed to pay their own taxes or threatened a taxpayer with an audit. In 20 cases, misconduct was found that did not involve taxpayers; the remaining 21 cases involved non-IRS employees, such as people impersonating tax collectors.[67]

[58]Chief Justice Rehnquist has said that "[t]he number of cases brought to the federal courts is one of the most serious problems facing them today," "1998 Year-End Report on the Federal Judiciary," *Third Branch*, Jan. 1999, p. 2, and that such overload is a problem requiring "immediate attention," "1998 Year-End Report on the Federal Judiciary," *Third Branch*, Jan. 2000, p. 2.

[59]The long running damages litigation brought against the IRS by Dr. Barrett comes to mind. The "horror story" of the improper IRS disclosures as to him was matched by the "horror story" of the protraction and expense of the ensuing damages litigation. Westlaw lists 18 items in the direct history of the case (including decisions, reversals, remands, affirmances, opinion withdrawals, and a *certiorari* denial) and one related reference. The first opinion was rendered in 1985 and the last (I hope) in 1997. The Fifth Circuit rightly described this litigation as a "saga." *Barrett v. United States*, 100 F.3d 35, 36 (5th Cir. 1996), *rehearing and suggestion for rehearing en banc denied* 108 F.3d 335 (5th Cir. 1997).

[60]Unlike *Bivens* actions, which have little to show for the time and money invested in prosecuting, defending, and deciding them.

[61]TBOR3 created section 7426(h) and amended sections 7431 and 7433.

[62]Congress's investigatory arm, the General Accounting Office, recently reported that it had been unable to substantiate the allegations. *See* GAO/OSI-99-9R, *Doc 2000-11630 (52 original pages), 2000 TNT 80-13* (Apr. 25, 2000); *see also* Ryan Donmoyer, "Secret GAO Report Is Latest to Discredit Roth's IRS Hearings," *Tax Notes*, April 24, 2000, p. 463. The GAO report concluded in part:

> The witnesses were correct in some of the facts supporting their allegations in some of the cases. However, our investigation established that the allegations themselves had been based on an incomplete awareness of the total circumstances surrounding the matters. We found that each manager had acted within his or her discretion and openly discussed relevant issues with both the employee and senior management. Their decisions were approved by appropriate individuals and were documented in the files. These managers followed IRS policies and procedures relating to auditing taxpayers.

2000 TNT 80-13, section 2.

[63]For prediction that the TBOR3 burden-of-proof rules will lead to substantial wasteful litigation once those rules become fully effective, see Johnson, Section 7491, *supra* note 5, at 463-69.

[64]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1136.

[65]*See* note 18 *supra*.

[66]David C. Williams, Treasury's Inspector General and no apologist for the IRS, remarked: "We now are receiving large numbers of allegations that are untrue." Quoted by David Cay Johnston, "I.R.S. Workers Face More Investigations by Treasury Agents," *New York Times*, Nov. 18, 1999, p. A1.

[67]*Id.* Of course, cases involving wrongdoing by non-IRS personnel or failure by IRS personnel to file their own tax returns would not be section 7438 cases. Refining the figures, then, the great bulk of complaints of IRS abuse of taxpayers were unwarranted.

- Two of the most important of the TBOR3 changes were liberalization of the relief rules as to spousal joint liability[68] and establishment of the collection due process rules.[69] The General Accounting Office reports that these rules have "increased IRS' workload far more than [had been] anticipated" at the time of their enactment.[70] As of February 2, 2000, the IRS had received almost 64,000 spousal relief claims.[71] "IRS officials were concerned about the agency's ability to process all the cases in a timely manner."[72] In 1999, the IRS Appeals Office received about 7,000 collection due process cases, which "represented a significant amount of additional work."[73] Relatively few of these cases have worked their way through the courts, but there already is reason to think that many of these claims are unwarranted.[74]

B. Relation of Sec. 7438 to Existing Damages Sections

Proposed section 7438 would include the following exception: "No liability shall arise under this section with respect to any act . . . a civil damage action with respect to which is available under another section of [the code]."[75] Despite this exception (or because of it), coordination problems would exist, and they would spawn additional and unproductive litigation.

To illustrate, focus on current section 7432. (A similar exercise could be performed as to other existing damages sections.) Section 7432 authorizes damages for knowing or negligent failure to release a tax lien. As is typical of existing damages provisions, section 7432 contains both exhaustion of remedies[76] and mitigation of damages[77] requirements. Suppose that an IRS officer negligently failed to release a lien but also that either (1) the taxpayer failed to use available review and appeal rights within the Service or (2) all of the damages resulting from the Service's failure could have been avoided had the taxpayer taken reasonable steps of mitigation, which she failed to do. Damages would not be available in this situation under section 7432. The key question is: would damages nonetheless be available here under section 7438?

[68]Section 6015.

[69]Sections 6320 and 6330.

[70]General Accounting Office, *supra* note 51, para. 4.

[71]Joint Comm. on Taxation, *supra* note 39, para. 129.

[72]General Accounting Office, *supra* note 51, para. 32.

[73]*Id.* para. 34.

[74]For example, in *Goza v. Commissioner*, 114 T.C. No. 12 (March 17, 2000), *Doc 2000-8459 (13 original pages), 2000 TNT 54-70*, the court rejected collection due process claims based on what it termed "frivolous constitutional claims." *See also Van Fossen v. Commissioner*, T.C. Memo. 2000-163, *Doc 2000-14286 (4 original pages), 2000 TNT 98-14* (May 18, 2000).

[75]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (section 7438(b)(4)).

[76]"A judgment for damages shall not be awarded . . . unless the court determines that the plaintiff has exhausted the administrative remedies available to such plaintiff within the Internal Revenue Service." Section 7432(d)(1).

[77]"The amount of damages awarded . . . shall be reduced by the amount of such damages which could have been mitigated by the plaintiff." Section 7432(d)(2).

The answer depends on the construction given to the section 7438 exception quoted above. Two competing constructions are possible, leading to different answers. One possibility is that "available under another section" could mean actual availability. Under this view, section 7438 damages would be available whenever section 7432 damages couldn't be obtained for any reason (here, the failure of the exhaustion or mitigation requirements). Thus, a section 7438 action would lie in our hypothetical.

The other possibility is that "available under another section" could mean categorical availability. Under this view, the exception would oust section 7438 whenever another code section offers damages as to the category of misconduct involved, even if — because of failure of one or another element — suit under that other section would fail on the facts of the particular case. On such an interpretation, a section 7438 action would not lie in our hypothetical.

Here's the problem. One could expect judicial division on this point: some courts would opt for "actual availability" while others would choose "categorical availability." There would be expense and uncertainty during the period of litigation — perhaps years — until an authoritative answer is given.

This concern is supported by actual experience as to another tax procedure issue: the interrelation of the statute-of-limitations mitigation rules[78] and the doctrine of equitable recoupment.[79] Both sets of rules can, in particular circumstances, be used to avoid statute-of-limitations objections to a claim, although the latter is defensive only (can be used only to offset a claim by the other side) while the former can be used offensively.[80]

> ***There are four grounds on which to believe that section 7438 would produce considerable litigation — much of it meritless — imposing excessive burdens on the resources of courts and litigants.***

The decisions agree that equitable recoupment may be applied when a particular case clearly falls outside the ambit of the mitigation rules (for example, when the case involves a kind of tax not covered by the mitigation rules).[81] However, the cases disagree in situations in which the two sets of rules potentially overlap, that is, when recoupment is asserted in a case categorically within the mitigation rules but in which

[78]Sections 1311-1314.

[79]*See, e.g., Bull v. United States*, 295 U.S. 247 (1935); Arthur W. Andrews, "Modern Day Equitable Recoupment and the 'Two Tax Effect': Avoidance of the Statutes of Limitations in Federal Tax Controversies," 28 *Ariz. L. Rev.* 595 (1986).

[80]*See generally* Steve R. Johnson, "The Taxpayer's Duty of Consistency," 46 *Tax L. Rev.* 537, 572-73 (1991).

[81]*See, e.g., Boyle v. United States*, 355 F.2d 233 (3d Cir. 1965); *United States v. Bowcutt*, 287 F.2d 654 (9th Cir. 1961).

those rules would not offer relief because of failure of one or another technical element. Some cases have taken an "actual availability" view (upholding the recoupment claim),[82] others a "categorical availability" view (rejecting the recoupment claim).[83]

One might hope that such controversy could be avoided by clear legislative history, but such an expedient is no guarantee of judicial unanimity. For instance, in the controversy described above, the relevant legislative history seems adverse to a "categorical availability" approach,[84] yet it was read by a major decision in the area to *support* just that approach.[85] Moreover, perhaps reflecting the strong attacks made in recent years on judicial reliance on legislative history,[86] results contrary to legislative history sometimes are reached in tax cases.[87]

Uncertainty and expense would exist on account of the likely conflicts among the courts in interpreting section 7438's coordination exception.

So, litigation and division would arise as the relationship between section 7438 and existing damages sections was argued in the courts. Moreover, difficulties would be created regardless of which of the above constructions of the exception courts ultimately settled on. On one hand, should "categorical availability" become the preferred construction, the reach of section 7438 would be significantly circumscribed. For instance, section 7433(a) already authorizes damages for violation of both statutes and regulations governing the collection function, and that function has been the one in which IRS abuses have most frequently been asserted. Other existing damages sections could squeeze section 7438 yet more under a categorical reading of the exception.

Yet, an "actual availability" construction also would be problematic. Professor Lederman could have proposed section 7438 as a replacement for existing damages sections. She chose instead to leave them in place and add section 7438 as a supplementary remedy. Presumably, this choice reflects a desire to respect congressional judgments where already expressed.[88] But such a desire would be significantly eroded were the coordination exception to section 7438 interpreted in "actual availability" fashion. In the hypothetical above, for instance, a taxpayer could obtain damages under section 7438 for failure to release a lien even though she could not obtain such damages under section 7432 because of the exhaustion and mitigation rules. Essentially, that would be "back door" repeal of the exhaustion and mitigation rules.

In summary, there would be difficulties in coordinating section 7438 with the code's current damages sections. Uncertainty and expense would exist on account of the likely conflicts among the courts in interpreting section 7438's coordination exception. Further, depending on how such conflicts ultimately were resolved, either section 7438 would be limited or existing congressional judgments would be undercut.

C. Relation of Sec. 7438 to the Exclusionary Rule

The justification for, and explanation of, section 7438 touches the exclusionary rule at two points. First, one of the principal referenced examples of IRS abuse is the *Payner* case, in which the Supreme Court held that the exclusionary rule does not prevent use of evidence as to the taxpayer obtained by the IRS by illegally searching another person's briefcase.[89] Second, section 7438 is intended to ameliorate effects of the Supreme Court's *Caceres* decision, which held that the exclusionary rule does not prevent use of evidence obtained in violation of procedures set out in the Internal Revenue Manual.[90]

It is unclear that damages would be allowable under section 7438 in either a *Payner* or *Caceres* situation. Time and money would be spent litigating such matters, without a worthwhile pay-off to society from the investment. I say this for the following three reasons.

(1) Damages would be allowable under section 7438 when an IRS person commits, "with respect to a taxpayer," any act violating specified rules.[91] Many courts likely would read this language as meaning "with respect to the taxpayer who now is seeking damages." How substantial would the nexus have to be between the plaintiff and the wrongful act? A court might find

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[82] *E.g., Hufbauer v. United States*, 297 F. Supp. 247 (S.D. Cal. 1968).

[83] *E.g., Brigham v. United States*, 470 F.2d 571, 577-78 (Ct. Cl. 1972), *cert. denied* 414 U.S. 831 (1972); *Gooding v. United States*, 326 F.2d 988, 995-96 (Ct. Cl.), *cert. denied* 379 U.S. 834 (1964).

[84] According to the legislative history, the mitigation rules were designed to "supplement the equitable principles applied by the courts," not to supplant them. S. Rep. No. 1567, 79th Cong., 3d Sess. 49 (1938), *reprinted in* 1939-1 C.B. (pt. 2) 777, 815.

[85] *Benenson v. United States*, 385 F.2d 26, 32 n.8 (2d Cir. 1967). The *Benenson* court phrased the "categorical availability" view as follows:

> [R]ecoupment should not be available whenever a case is arguably within the scope of the mitigation provisions. . . . Recoupment, then, would not be available if a court should find that the situation in question falls within the general scope of the statutory provision but does not meet each requirement of the statute.

Id. at 32 n.8 and 34.

[86] *See generally* William D. Popkin, *Statutes in Courts* 248-53 (1999).

[87] *See, e.g., Beyer v. Commissioner*, 916 F.2d 153, 156-57 (4th Cir. 1990); *Redlark v. Commissioner*, 106 T.C. 31, 42-46, *Doc 96-1488 (71 pages), 96 TNT 9-9* (1996), *rev'd* 141 F.3d 936, *Doc 98-12692 (11 pages), 98 TNT 74-4* (9th Cir. 1998).

[88] Of course, Congress's judgment involves what it has chosen not to enact, as well as what it has chosen to enact. Congress's judgment to date has been that damages remedies against the IRS should be only selective, not comprehensive.

[89] *See* notes 8 and 9 *supra*.

[90] *United States v. Caceres*, 440 U.S. 741 (1979); *see* text accompanying notes 118-119 *infra*.

[91] Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (section 7438(a)).

a sufficient nexus in *Payner* since the IRS's illegal search revealed information about Payner and had an effect on him — without the illegally obtained evidence the government would not have been able to prove that Payner had falsified his tax return.

But it is at least equally likely that another court would hold the nexus inadequate. The records the IRS photographed did not belong to Payner; the briefcase that contained those records did not belong to Payner; and the apartment in which the search took place did not belong to Payner and was not occupied by Payner. The Supreme Court held, for purposes of the exclusionary rule, that Payner lacked standing to complain about the IRS's violation of the privacy rights of another (the owner of the briefcase).[92] It would not be amazing to see a court similarly hold that Payner could not obtain damages, even under section 7438, on account of the IRS's violation of the privacy rights of that other.[93]

(2) Damages would not be allowable under section 7438 "with respect to any act . . .that results in actual damages to the taxpayer of less than $1,000."[94] Did the IRS's actions in *Payner* and *Caceres* result in actual damages of at least $1,000? Payner would not have been convicted of falsifying his return without the illegal search, and Caceres would not have been convicted of attempting to bribe an IRS agent without the unauthorized recording. Although those taxpayers had in fact committed the crimes of which they were charged, the IRS couldn't have proved it without the fruits of the misconduct. Presumably, Payner and Caceres could have earned at least $1,000 each had they been free, instead of incarcerated as a result of these convictions. Would they thus have had good section 7438 claims?

Not necessarily. The ultimate cause of Payner's and Caceres's incarceration was that they had in fact committed the crimes of which they were charged. Payner had falsified his return, and Caceres had tried to bribe a government official. Yes, the IRS misconduct enabled these crimes to be proved in a court of law. But, in the language of section 7438, didn't the imprisonment of Payner and Caceres "result[]," originally and fundamentally, more from their own criminal behavior than from the IRS's behavior?

(3) The foregoing points suggest that arguments can be made, from the language of section 7438 itself, that that section would not fulfill Professor Lederman's apparent desire that plaintiffs like Payner and Caceres be able to recover damages from the IRS. But litigation is not mechanical. Human beings — judges — apply texts in light of their values and sense of fairness. Thus, the following compounding problem.

Of course the behavior of the IRS in *Payner* and *Caceres* was deplorable. But Payner and Caceres are hardly attractive litigants either. Judges would ask themselves: "Do we really want to compensate people like these? Is it a good use of resources to give money to these criminals?" Some judges surely would get past this scruple, but others would not. At least, if the foregoing points of statutory interpretation are debatable, this equities "wild card" might influence the result reached.[95]

> ***There are reasons in both language and perceived equities to suspect that application of section 7438 would be contentious and inconsistent in exclusionary rule cases like those cited by Professor Lederman.***

Thus, there are reasons in both language and perceived equities to suspect that application of section 7438 would be contentious and inconsistent in exclusionary rule cases like those cited by Professor Lederman. The result would be additional expensive litigation without socially redeeming result.

D. 'Insufficient Explanation' Cases

It appears that cases in which IRS notices contain insufficiently detailed explanations are among those intended to give rise to damages under section 7438. I say this because the portion of the rationale entitled "Real Remedies" includes both discussion of the supposed problem of unclear enforcement of section 7522[96] and reference to the *Nicholson* case, described as "an extremely broad notice of deficiency in [an] unreported income case" and an instance of "IRS abuse[] of power."[97]

This class of case exemplifies the potential for section 7438 to engender wasteful litigation without meaningful enhancement of taxpayer protections. This is so for the following three reasons.

(1) "Insufficient explanation" cases rarely involve any real harm to the taxpayer. A notice usually is not an isolated event but instead is part of a course of

[92]*United States v. Payner*, 447 U.S. 727, 731-32 (1980).

[93]Another possible reading of the wording of section 7438 is that "a taxpayer" means "any taxpayer," not just the taxpayer who now seeks damages. But even that expansive interpretation might not have sufficed to allow Payner to collect damages under section 7438. Section 7701(a)(14) provides: "The term 'taxpayer' means any person subject to any internal revenue tax." The owner of the briefcase appears to have been a nonresident alien, so may not have been a U.S. taxpayer.

[94]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (section 7438(b)(3)). "Actual damages" would include consequential damages. *Id.* at 1142 (section 7438(e)(3)).

[95]A similar tug has complicated development of criminal procedure rules. "[M]any [criminal procedure] areas, such as [post *Miranda* warning] interrogation . . . , go unregulated because, even though a majority of the Court may feel the need for rules, they are reluctant to create new possibilities for evidentiary exclusion for defendants." Craig M. Bradley, *The Failure of the Criminal Procedure Revolution* 84-87 (1993).

[96]A TBOR1 section describing the required contents of certain IRS notices.

[97]*Nicholson v. Commissioner*, 65 T.C.M. 2478, *Doc 93- 4977 (63 pages)*, *93 TNT 91-23* (1993) (involving deficiency notices issued in 1988, preceding the effective date of section 7522).

dealing between the IRS and the taxpayer. The taxpayer typically understands the nature of the Service's position from the entire course of dealing, if not from the particular notice taken alone.

For instance, when the IRS issues a notice of deficiency,[98] the issuance generally is preceded by an audit and the opportunity for discussion with the IRS Appeals Office. And, if the taxpayer contests in court the determinations in the deficiency notice, the issuance is followed by a possible further round of discussions with the IRS Appeals Office, discussions with IRS Counsel or the Department of Justice, and whatever pre-trial discovery the taxpayer chooses to engage in. These pre- and post-issuance contacts with the government give the taxpayer ample opportunity to learn the theories behind the IRS's determinations, even if the notice itself lacks substantial detail or explanation.

By way of illustration, consider the *Fidelity Equipment* section 7429 case.[99] The IRS had made a jeopardy assessment against the taxpayer. In such cases, the IRS is required, within five days, to "provide the taxpayer with a written statement of the information upon which [it] relied in making such assessment."[100] The IRS timely issued such a statement, but its "explanation" was mere boilerplate, a general summary of the conditions under which jeopardy assessments are permitted. The court agreed with the taxpayer that "such conclusionary statements do not fulfill the requirements of [section 7429]."[101]

Nonetheless, the court refused to invalidate the jeopardy assessment. Why? The taxpayer had suffered no harm on account of the statement's insufficient explanation. "Through the process of discovery the taxpayers have been informed of the information relied upon by the Government. Any deficiency [of explanation] in the notice issued by the Government is now immaterial. The [taxpayers] were not prejudiced by the lack of information contained in the notification letters."[102]

(2) Since taxpayers rarely suffer harm in "insufficient explanation" cases, proposed section 7438 would not allow them to recover damages,[103] despite the apparent desire of the proposal's author that they should receive damages.[104]

(3) I have argued that taxpayers should not and would not be compensated under section 7438 in "insufficient explanation" cases. Nonetheless, it is probable that many taxpayers would bring section 7438 suits in such cases. Professor Lederman appears to think that they should, and taxpayers — invoved in an emotion-charged controversy with the IRS and catching the whiff of money in the air — would often follow her lead.

The *Nicholson* case adds to my concern in this regard. Frankly, I do not consider *Nicholson* to be a case of an "IRS abuse[] of power." The deficiency notice's explanation of the unreported income adjustment *was* skimpy. However, it appears to have been a very long notice. By my count (separating sub-issues), there would have been about two dozen adjustments written up in the notice (most of which the IRS prevailed on at trial). Also, the taxpayers had pre-trial opportunities to glean information as to the IRS's theory regarding the unreported income: opportunities presented at audit, during discussions with Appeals and IRS Counsel, and, if necessary, by interrogatories.

Finally, one may infer from the report of the case that the taxpayers themselves contributed in no small way to whatever confusion existed in the controversy: they filed at least some returns late or not at all;[105] they offered arguments at trial they had not previously raised;[106] and the opinion repeatedly refers to the taxpayer's failures of proof at trial, suggesting that they likely also failed to offer support for their positions during audit. Despite the foregoing, the *Nicholson* taxpayers asked the court to shift to the IRS the burden of proof as to unreported income issues (a request the court denied). I doubt that taxpayers who would

[98]*See* section 6212.

[99]*Fidelity Equipment Leasing Corp. v. United States*, 462 F. Supp. 845 (N.D. Ga. 1978), *order vacated on other grounds*, 81-1 U.S. Tax Cas. para. 9319 (N.D. Ga. 1981).

[100]Section 7429(a)(1)(B).

[101]462 F. Supp. at 848.

[102]*Id.*

[103]Section 7438 would not impose liability on the IRS for any act "that results in actual damages to the taxpayer of less than $1,000." Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (section 7438(b)(3)).

[104]Two other examples of wrongs that section 7438 would not redress. First, the IRS may still be taking "dollars collected" into account in evaluating the job performance of its

(Footnote 104 continued in next column.)

collection personnel, despite the fact that doing so is illegal. *See id.* at 1140 n.90 (quoting Kenneth H. Ryesky, "Of Taxes and Duties: Taxing the System With Public Employees' Tax Obligations," *31 Akron L. Rev.* 349, 383 (1998)); *Kiplinger Tax Letter*, June 9, 2000, p. 2 (reporting that enforcement statistics are still being used to evaluate IRS agents in up to 8 percent of reviews, according to a congressional audit). Proving a causal connection between the possible persistence of this practice and actual harm suffered by a taxpayer in a particular case would seem exceedingly difficult. Thus, section 7438 would not redress this problem.

Second, one recently publicized "horror story" involves the *Boyer* gift/estate tax case. *See* David Cay Johnston, "A Gift or an Estate? That Is the Multimillion-Dollar Question," *New York Times*, Oct. 31, 1999, section 3, p. 16. However, the wrenching harms in that case resulted from incompetence by the Boyers' attorney and bad judgment — not procedural violations — by IRS personnel. Since no statute, regulation, revenue procedure, or Manual provision was breached, section 7438 would be useless to the Boyer family.

[105]The taxpayers conceded that they were liable for a section 6651 failure-to-file penalty. 65 T.C.M. at 2496.

[106]*Id.* at 2488.

proceed as they did in *Nicholson* would shrink from taking a grab at the section 7438 jackpot.[107]

In summary of this Part III, in considering whether to adopt a new legal remedy the costs of that remedy must be considered. Adoption of section 7438 would lead to many more suits in district court. Of course, a new cause of action can be worthwhile, even if it will spawn much litigation, if that litigation will produce substantial additional good. I do not believe section 7438 would satisfy this criterion. The resources costs inflicted by section 7438 would be disproportionate to the resultant benefits. At a time when the federal court system already groans under the weight of its case load, adoption of section 7438 would be unwise.

IV. Increased IRS Abuses

A key feature of section 7438 would be that agents' violation of the Internal Revenue Manual would be grounds for seeking damages. Of course, such violation would be compensable only if at least negligent.[108] But that might not be much of a limit. Agents receive the Manual, are schooled in its contents, and are supposed to conduct their business pursuant to its directives. In all but exceptional cases,[109] violation of a Manual provision by an IRS agent likely would be seen as virtually negligence per se.[110]

This would be a sharp break not only with damages sections now in the code[111] but also with case law in other tax areas.[112] The failure of an IRS agent to adhere to prescriptions in IRS procedural regulations or the Manual typically is not grounds for relief, and the courts repeatedly have refused to cobble isolated exceptions into "a general doctrine of institutional misconduct or bad faith" applicable against the IRS.[113] For instance, violations of Manual rules as to case processing,[114] Appeals Office consideration,[115] and manner of obtaining statute-of-limitations extensions[116] all have been held not to invalidate subsequent deficiency determinations by the IRS.

That approach is right and should not be overthrown for damages purposes. The courts have repeatedly held that the procedural regulations and the Manual are merely directory, not mandatory, and that their purpose is to guide IRS employees, not to confer substantive rights on taxpayers.[117] That being so, such rules create no reliance interest.

There is an even more important reason for the courts' reluctance to inquire into agents' violation of Manual provisions. Law-and-economics has taught us to think in terms of the behavioral effects of rules. If the IRS can be held liable for damages — actual damages and perhaps punitive damages as well, all without monetary cap — on account of Manual violations, what incentive does that create as to how the IRS writes the Manual? Enactment of section 7438 could cause the Service to refrain from adding new rules to the Manual, to delete current ones, or to convert them from required to optional procedures. If there is no requirement in the Manual, the IRS can't be compelled to pay damages for violating it.

But such an incentive would be perverse in terms of tax administration and taxpayer protection. The absence of rules is precisely the environment in which abuses flourish; taxpayers have more to fear from agent discretion unbounded by rules than from occasional agent disregard of extant rules.

This point was made by the Supreme Court in *Caceres*, a decision of which Professor Lederman disapproves to the extent that it leaves no remedy against the misconduct of the IRS.[118] A taxpayer charged with attempting to bribe an IRS agent moved to suppress tape recordings of his conversations with the agent on the ground that they had been made in violation of Manual requirements. The Court rejected this argument, remarking:

> We cannot ignore the possibility that a rigid application of an exclusionary rule to every

[107]As another example of the danger, consider *LeFleur*, one of the section 7522 cases cited in the proposal's rationale. *See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1139 n.72. In that case, the court rejected the taxpayers' contention, holding that the explanation in the notice of deficiency was sufficient, thus that the burden of proof should not shift to the IRS. The LeFleurs argued for a burden shift. Would they also have brought a damages suit for "insufficient explanation" had section 7438 been in effect?

[108]*Id.* (Section 7438(a)).

[109]Such as, perhaps, violation of an unanticipated new rule in a just issued Manual supplement that the agent hadn't yet received.

[110]Of course, as a practical matter, the byzantine organization and numbering system make actually finding an applicable Manual instruction a formidable, sometimes almost impossible, task. I doubt, though, that the IRS could effectively defend against a damages suit on the ground that it constructed its own Manual so poorly that its agents are not chargeable with knowledge of its contents.

[111]*See* note 21 *supra*.

[112]Again, this is intentional. Professor Lederman rejects the wisdom of that case law. *See* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141.

[113]*Klein v. Commissioner*, 52 T.C.M. 853, 869 (1986); *see also Graham v. Commissioner*, 82 T.C.M. 299, 308 (1984), *aff'd* 770 F.2d 381 (3d Cir. 1985).

[114]*E.g., Riland v. Commissioner*, 79 T.C. 185, 199 (1982).

[115]*E.g., Cataldo v. Commissioner*, 60 T.C. 522, 523 (1973), *aff'd per curiam* 499 F.2d 550 (2d Cir. 1974).

[116]*E.g., Vallone v. Commissioner*, 88 T.C. 794 (1987).

[117]*E.g., In re Carlson*, 126 F.3d 915, 922 (7th Cir. 1997), *cert. denied* 523 U.S. 1060 (1998); *United States v. Horne*, 714 F.2d 206, 207 (1st Cir. 1983); *Luhring v. Glotzbach*, 304 F.2d 560, 564-65 (4th Cir. 1962); *see* Bryan E. Gates, "The Internal Revenue Manual — The Practitioner's Tool," *Tax Notes*, Jan 18, 1999, p. 358, at 360-61.

[118]*United States v. Caceres*, 440 U.S. 741 (1979); *see* Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1141 (stating that "Case law, such as *Caceres*, . . . would be overruled by the new provision."). Contextually, I understand this to mean that *Caceres* would still stand as to the exclusionary rule in criminal cases but that section 7438 would provide an independent civil remedy. That is, people like Caceres would still go to jail but they could sue the IRS for damages.

> regulatory violation could have a serious deterrent impact on the formulation of additional standards to govern prosecutorial and police procedures. . . . [T]he result might well be fewer and less protective regulations. In the long run, it is far better to have rules like those contained in the IRS Manual, and to tolerate occasional erroneous administration . . . , than either to have no rules except those mandated by statute, or to have them framed in a mere precatory form.[119]

Professor Lederman is aware that section 7438 "might discourage the IRS from restraining its own actions through provisions in the Manual," but concludes that the new provision is necessary nonetheless.[120] Specifically, she offers that "[t]he appropriate response to IRS cutbacks on internal procedures would be codification of those procedures."[121]

Unfortunately, confidence could not be reposed in that alternative. Congress's attention to IRS oversight can wane as well as wax, and its ability to act with seriousness depends on concatenations of personal, political, and policy factors, as well as the press of competing domestic and international issues. The possibility of episodic legislation cannot satisfactorily substitute for an Executive Branch motivated to properly govern itself through effective and comprehensive internal rules.

In short, proposed section 7438 risks creating an environment in which more, not less, IRS abuse will occur, the opposite of the proposal's intended effect.

In short, proposed section 7438 risks creating an environment in which more, not less, IRS abuse will occur, the opposite of the proposal's intended effect. The current system seeks to prevent abuses in the first place. That is a better approach than risking more abuses, then paying compensation for them.

[119]440 U.S. at 755-56. To the same effect, see Vallone, *supra*, 88 T.C. at 807, and *Riland*, *supra*, 79 T.C. at 201-02.

[120]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1142.

[121]*Id.*

V. Conclusion

The current system, including taxpayer rights changes to date, seeks to prevent IRS misconduct mainly through rules and personnel sanctions, authorizing money damages only selectively. Proposed section 7438 would encourage taxpayers to take a "litigation first" approach. The current system surely is not perfect. Still, TBOR2 and TBOR3 should be given time to work, and their impact should be carefully assessed, before we consider adopting a new and potentially disruptive approach like proposed section 7438.

Professor Lederman says rightly that "remedies matter."[122] But disadvantages as well as benefits must be considered in deciding whether to create new remedies. The gains from increased compensation and increased deterrence in appropriate cases that might be produced by a new, residual damages provision would, I believe, be considerably exceeded by the costs inflicted by it. In this case, the cure would be worse than the disease.

Postscript

This postscript relates to Part III.D. of this article, in which I argue that the proposed new damages right would not redress "insufficient explanation" cases but would engender wasteful damages litigation of them. In communication after this article was submitted for publication, Professor Lederman informed me that she does not intend the proposal to cover such areas.

This underscores how hard it is to control legislation by horror stories and the overcorrection that is its main peril. Were Congress inclined to enact the proposal, it could reasonably believe that "insufficient explanation" cases were intended to be covered (since instances of them are discussed under the heading "Real Remedies" and are cited as examples of IRS abuse) or even that they *should* be so covered, regardless of what Professor Lederman intends. As happened too often in TBOR3, a Congress stirred up by talk of IRS abuses can stampede and be very hard to rein back in. Discussion of "insufficient explanation" cases as part of the proposal's rationale risks that outcome. Excluding them entirely from the discussion would be the better course if they are not intended to be covered by the new remedy.

[122]Lederman, Rights, Wrongs and Remedy, *supra* note 6, at 1138.